

DOCUMENT RESUME

04295 - [B3394623] (Restricted)

The Sound Health Association: A Federally Qualified Health Maintenance Organization. HRD-77-119; B-164031(5). December 2, 1977. 26 pp. + 5 appendices (15 pp.).

Report to Rep. Paul G. Rogers, Chairman, House Committee on Interstate and Foreign Commerce: Health and the Environment Subcommittee; Sen. Edward M. Kennedy, Chairman, Senate Committee on Human Resources: Health and Scientific Research Subcommittee; by Elmer B. Staats, Comptroller General.

Issue Area: Health Programs: Health Maint. Organization's Compliance with Law (1214). their Viability as Alternative to fee-for-service mode of Producing Care

Contact: Human Resources Div.

Budget Function: Health: Health Care Services (551).

Organization Concerned: Department of Health, Education, and Welfare; Sound Health Association, Inc., Tacoma, WA.

Congressional Relevance: House Committee on Interstate and Foreign Commerce: Health and the Environment Subcommittee; Senate Committee on Human Resources: Health and Scientific Research Subcommittee.

Authority: Public Health Service Act (42 U.S.C. 246(e)). Health Maintenance Organization Act of 1973, as amended. P.L. 94-63. 42 U.S.C. 242b (Supp. V). 42 U.S.C. 229b. 42 U.S.C. 299j.

The Sound Health Association, Inc., of Tacoma, Washington, is a consumer-owned, prepaid health plan and was the first health maintenance organization qualified by the Department of Health, Education, and Welfare (HEW) under the Health Maintenance Organization Act. The provision of health care services on the basis of prepaid rates provides incentives for the organization to emphasize preventive medicine to reduce overall health care costs. Findings/Conclusions: The Sound Health Association appears to be providing comprehensive prepaid health care in accordance with the act. Although delays in the publication of implementing regulations slowed the development of the association and caused increased operational costs, it should have enough operating income to meet operating costs by the second quarter of calendar year 1979 provided that it meets enrollment projections, improves marketing efforts, and controls costs. The association requested a waiver of the open enrollment requirement. HEW did not issue the waiver, but it has not forced the association to have an open enrollment period. The association is serving the indigent but has not actively sought enrollment of high risk individuals. As of December 31, 1976, it was providing comprehensive health care services to 6,016 members. The Federal Government requires employers to include a health maintenance organization in their employees' health benefit plans. For employees represented by a labor union, the health maintenance organization alternative is subject to

collective bargaining. Generally, unions have not offered the plan as an option. (Author/SW)

4623

**RESTRICTED — Not to be released outside the General Accounting Office except on the basis of specific approval by the Office of Congressional Relations.**

04295



## ***REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES***

---

### **The Sound Health Association-- A Federally Qualified Health Maintenance Organization**

The Sound Health Association, Inc., of Tacoma, Washington, is a consumer-owned, prepaid health plan and was the first health maintenance organization qualified by the Department of Health, Education and Welfare under the law. As of December 31, 1976, the Sound Health Association was providing comprehensive health care services to 6,016 members.



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-164031(5)

The Chairman and Ranking Minority Member  
Subcommittee on Health and Scientific  
Research  
Committee on Human Resources  
United States Senate

The Chairman and Ranking Minority Member  
Subcommittee on Health and the  
Environment  
Committee on Interstate and Foreign  
Commerce  
House of Representatives

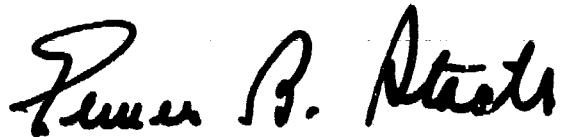
This report discusses findings and conclusions on our evaluation of Sound Health Association, Inc., of Tacoma, Washington, a federally qualified health maintenance organization. A draft report was sent to Sound Health for review and comment. Where appropriate, we have included its comments in the report.

This is the first in a series of 14 individual reports to be issued in compliance with section 1314 of the Health Maintenance Organization Act, as amended. An overall report summarizing all our evaluations initiated under section 1314 will be submitted to the Congress by June 1978.

As requested by the Chairman and Ranking Minority Member, Subcommittee on Health and Scientific Research, Senate Committee on Human Resources, we will be forwarding separate reports on each health maintenance organization evaluation to them and also to the Chairman and Ranking Minority Member, Subcommittee on Health and the Environment, House Committee on Interstate and Foreign Commerce.

We are also sending copies of this report to the Department of Health, Education, and Welfare. The Civil Service Commission will receive copies of reports on health maintenance organizations which participate in the Federal Employees Health Benefits Program.

While we hope that this and our subsequent evaluations of federally qualified health maintenance organizations will be of use to the subcommittee(s) and the responsible Federal agencies, we believe that the public disclosure of our discussion of several of the issues in the reports may inadvertently and inappropriately have an adverse effect on the health maintenance organizations' marketing capability and financial viability. Therefore, we have limited the distribution of this report, and unless released by the subcommittee(s), we will restrict the public release of this and other reports in this series.

A handwritten signature in black ink, reading "James B. Stacks". The signature is written in a cursive, slightly slanted style.

Comptroller General  
of the United States

D I G E S T

This report, on the Sound Health Association, Inc., Tacoma, Washington, is one in a series of evaluations of individual health maintenance organizations. A health maintenance organization provides health care services to its members based on prepaid rates. This provides incentive for an organization to emphasize preventive medicine to reduce overall health care costs.

Sound Health appears to be providing comprehensive prepaid health care to its members in accordance with the Health Maintenance Organization Act. Although delays in the publication of implementing regulations by the Department of Health, Education, and Welfare (HEW) slowed the development of Sound Health and caused increased operational costs, Sound Health should have enough operating income to meet operating costs by the second quarter of calendar year 1979.

Sound Health requested a waiver of the open enrollment requirement. HEW did not issue the waiver, but it has not forced Sound Health to have an open enrollment period.

Sound Health is serving the indigent but has not actively sought enrollment of high risk individuals. Thus, its membership does not appear to represent the various age, social, and income groups in its service area.

Sound Health will not have enough income to meet operating expenses by the end of a 36-month Federal loan subsidy period. Late publication of regulations by HEW delayed Sound Health's enrollment program, and membership has lagged about 6 months behind original projections. However, Sound Health should attain a break-even point--operational revenues will equal operation expenses--by

the second quarter of calendar year 1979 provided that it

- meets enrollment projections,
- improves marketing efforts, and
- controls costs.

Employers in the Sound Health service area must include a health maintenance organization in their employees' health benefit plans. Although some employers resent this Federal requirement, those contacted said the added administrative costs of offering employees a health maintenance organization were negligible. Sometimes employers paid more for employee participation in the Sound Health plan than in other health benefit plans. However, in all cases, increased employer contribution was voluntary.

For employees represented by a labor union, the health maintenance organization alternative is subject to collective bargaining. Many employees in the Sound Health service area receive health benefits through union trust programs negotiated through collective bargaining. Sound Health has generally been unsuccessful in getting unions to offer the health maintenance organization as a health benefit plan option for members.

In commenting on this report in July 1977, Sound Health stated that they generally agreed with GAO's conclusions. They point out that the organization has grown to 9,200, the marketing system is better organized, and controls imposed on health services are working well.

# C o n t e n t s

		<u>Page</u>
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	Sound Health Association	2
	Federal financial assistance	4
	Scope of evaluation	5
2	HAS SOUND HEALTH BEEN ABLE TO MEET THE ORGANIZATIONAL AND OPERATING REQUIREMENTS OF THE HEALTH MAINTENANCE ORGANIZATION ACT?	7
	Open enrollment	7
	Enrollment of members broadly representative of its service area	9
	Describing the community rating system	12
3	WILL SOUND HEALTH BE ABLE TO OPERATE WITHOUT CONTINUED FEDERAL FINANCIAL ASSISTANCE?	14
	Optimistic enrollment projections and marketing problems	15
	Higher than anticipated utilization	18
	Audit of Sound Health	19
	Our financial projection	19
	Conclusions	21
4	WHAT IS THE EFFECT OF DUAL CHOICE ON EMPLOYERS AND SOUND HEALTH?	22
	Economic impact on employers	22
	Employer reaction	23
	Union resistance	24
5	QUALITY ASSURANCE PROGRAM	25



## APPENDIX

I	Letter dated May 20, 1976, from the Chairman and Ranking Minority Member, Subcommittee on Health, Senate Committee on Labor and Public Welfare	27
II	Letter dated July 26, 1977, from the President, Sound Health Association	29
III	Sound Health Association operating results for the quarters ended March 1975 through March 1976	31
IV	Organizational and operating requirements for health maintenance organizations	32
V	GAO actuarial projections for Sound Health Association	36

ABBREVIATIONS

GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
HMO	health maintenance organization

## CHAPTER 1

### INTRODUCTION

The Health Maintenance Organization (HMO) Act of 1973, as amended, requires GAO to evaluate the operations of certain HMOs which have been certified by the Department of Health, Education, and Welfare (HEW) as complying with the act's organizational and operational requirements and which have received financial assistance under the act.

Section 1314 of the act, as amended, requires us to report to the Congress on the ability of these qualified HMOs

- to meet the requirements of the act regarding their organization and operation, including the HMOs ability to include medically indigent and high risk individuals in their membership and to provide services to medically underserved populations, and
- to operate on a fiscally sound basis without continued Federal financial assistance.

The act directs us to study and report the economic effects on certain employers required by section 1310 of the act, as amended, to offer membership in qualified HMOs as an optional health benefit plan, an option referred to as dual choice.

The act also requires us to evaluate (1) the operations of distinct categories of HMOs in comparison with each other, (2) HMOs as a group as compared with alternative forms of health care delivery, and (3) the impact that HMOs, individually, by category, and as a group have on the public health. To the extent possible we will include such information in our summary report to the Congress. However, as noted in our September 3, 1976, report, "Factors That Impede Progress in Implementing the Health Maintenance Organization Act of 1973," no state-of-the-art agreement exists on what methods have been developed to provide comparative and health status information to be used for such evaluations. For this report we will describe the HMO's quality assurance program.

This evaluation concerns the Sound Health Association, Tacoma, Washington, and is one in a series of evaluations of HMOs to be conducted in compliance with the act. At the request of the Chairman and Ranking Minority Member, Subcommittee on Health and Scientific Research, Senate

Committee on Human Resources (formerly the Subcommittee on Health, Senate Committee on Labor and Public Welfare), separate reports on each HMO evaluation will be issued to them and to the Chairman and Ranking Minority Member, Subcommittee on Health and the Environment, House Committee on Interstate and Foreign Commerce. A report summarizing all our audits initiated under section 1314, as amended, will be submitted to the Congress by June 1978.

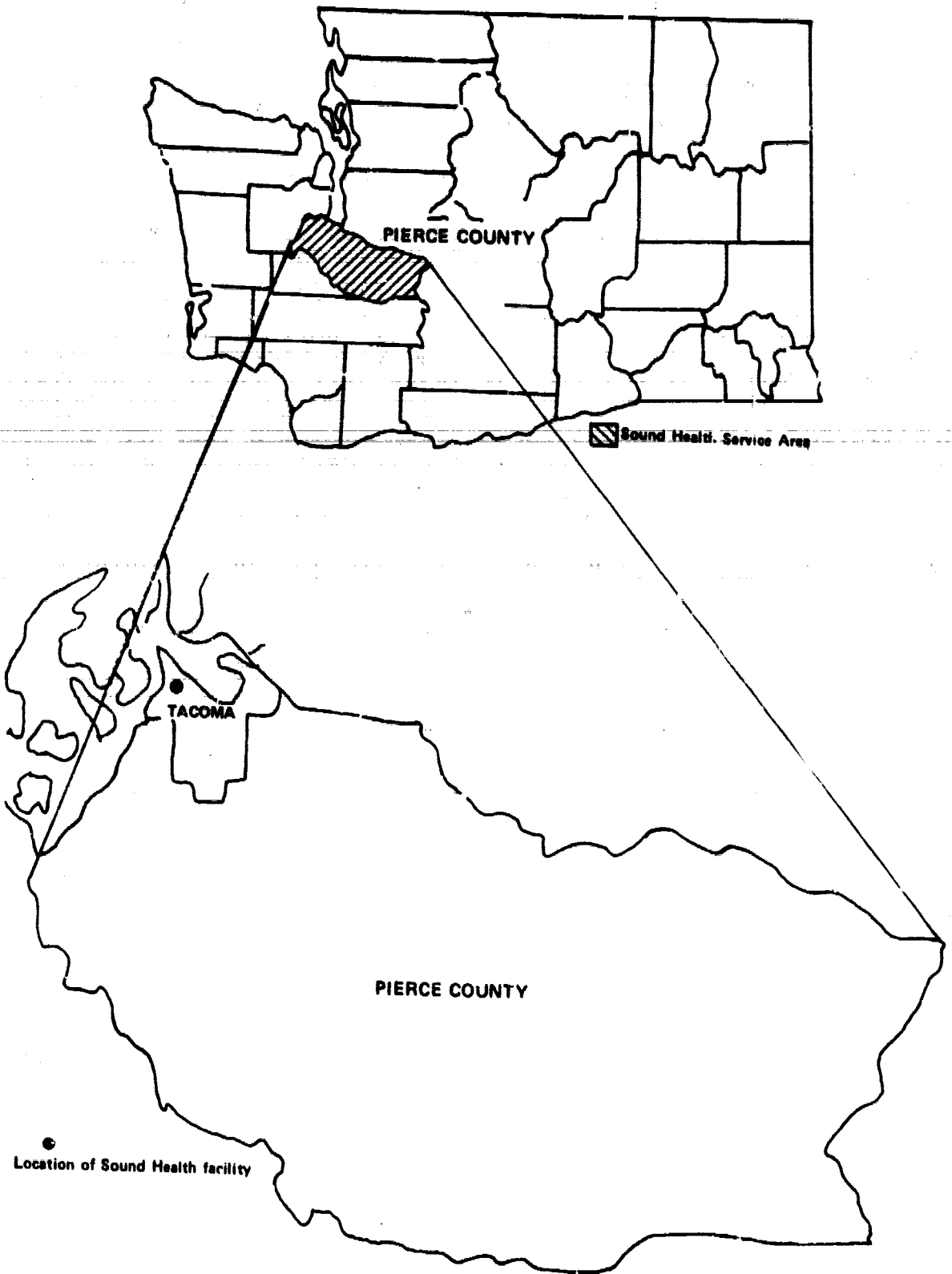
#### SOUND HEALTH ASSOCIATION

Sound Health was incorporated in June 1972 under Washington State laws as a member-owned nonprofit HMO and began enrolling members and providing prepaid health services in April 1974, before qualification as an HMO by HEW. Its board of directors, which is responsible for setting policy and guiding the affairs of the organization, is elected by its membership.

In June 1974 after publication of preliminary regulations covering the HMO Act, the board of directors voted to seek certification as a qualified HMO. Its original health plan was revised to include preventive dental care for children, outpatient mental health care, improved out-of-area medical benefits, and liberalized hospital benefits.

HEW certified Sound Health as a qualified HMO on November 29, 1974--the first HMO to be certified in the United States--and awarded the HMO a \$1 million loan, the first loan under this program.

Sound Health provides health care services primarily to members who live in Pierce County, Washington. (See page 3.) Sound Health furnishes outpatient health care at its health center facility in Tacoma, but inpatient care and specialized services, such as extended care and mental health services, are supplied through contracts with hospitals and other health care providers. The Sound Health outpatient facility can provide health care services for up to 12,000 members. Prospective enrollment groups received information stating that other convenient health care centers would be added as enrollment increases. The Sound Health director stated that some plans and personal contacts had been made to establish satellite health care clinics in two additional areas. He estimated these would be needed in the latter part of 1977.



## FEDERAL FINANCIAL ASSISTANCE

Federal financial assistance to prepaid health care delivery programs was available before the HMO Act under several sections of the Public Health Service Act (42 U.S.C. 246(e) (repealed Public Law 94-63), 42 U.S.C. 242b (1970 and Supp. V, 1975), 42 U.S.C. 229b (1970), 42 U.S.C. 299j (1970)). Between December 1971 and December 1974, Sound Health, or its predecessor, the Puget Sound Health Care Association, received three grants totaling \$428,382 under section 314(e) of the Public Health Service Act (repealed by Public Law 94-63). This section provides for grants to any public or nonprofit private agency, institution, or organization to cover partially the cost of (1) providing services to meet health needs which are limited by geographic scope or specialized regional or national significance or (2) initially developing and supporting new health services programs.

In January 1972 the Puget Sound Health Care Association received a grant of \$100,000 to fund the initial planning and developing of a hospital-based HMO. Unable to purchase a hospital facility, the Puget Sound Health Care Association changed the original concept of a hospital-based HMO to a community-based organization, and a successor corporation, Sound Health Association, was established. The grant was transferred to Sound Health in June 1972.

The HMO Act authorizes Federal financial assistance through grants and contracts to public or private nonprofit organizations for HMO feasibility studies, planning, and initial development.

The act requires each HMO to be fiscally sound. However, because developing HMOs may have difficulty meeting operating expenses, the act provides for Federal loans during their first 36 months. Interest accrues from the date of the loan closing and is to be paid in accordance with the loan agreement, which requires repayment of the principal beginning between the fourth and fifth anniversaries of the direct loan closing.

In June 1974, after 2-1/2 years of developmental activities supported by section 314(e) grants, Sound Health applied under the HMO Act, for an operational loan of \$563,000 and an initial development grant of \$124,520. HEW did not act on the loan application because it had not published its final HMO program regulations. As an interim measure, however, HEW awarded Sound Health an initial development grant of \$304,738.

Sound Health did obtain a Federal loan of \$1 million, effective November 1, 1974. The final amount of the loan was larger than the original amount requested because during its loan review process, HEW determined that Sound Health's losses would exceed its originally requested amount. Under the loan conditions, Sound Health must break even; that is, income must equal expenses by November 1977 and must have sufficient cash to begin loan principal repayment in July 1979.

As shown below Sound Health has received Federal funds totaling \$1,733,000; about 75 percent of the funds were provided under the HMO Act.

#### Federal Financial Assistance

<u>Type</u>	<u>Authority</u>	<u>Date awarded</u>	<u>Amount</u>	<u>Purpose</u>
Grant	Public Health Service Act, section 314(e)	(a)	\$ 428,382	Planning and development of a hospital- based HMO
Grant	HMO Act	7/26/74	304,738	Initial develop- ment
Loan	HMO Act	11/29/74	<u>1,000,000</u>	Initial deficit
Total			<u>\$1,733,120</u>	

a/Represents three section 314(e) grants covering the period Dec. 16, 1971, to Dec. 15, 1974.

#### SCOPE OF EVALUATION

Our review was done at the Sound Health Association, Tacoma; HEW's Health Services Administration Headquarters, Rockville; and HEW's region X offices, Seattle. We also interviewed employer representatives at their offices in Tacoma and Pierce County.

To determine Sound Health's ability to be fiscally sound without continued Federal financial assistance, we

--compared Sound Health's financial history to its initial financial projection submitted when applying for qualification and also for a Federal loan;

--reviewed the actuarial projections used by Sound Health and prepared new projections from data obtained during our review; and

--reviewed Sound Health's marketing program, its financial operations, and its systems to control over-utilization of services.

To evaluate Sound Health's ability to meet the other requirements and purposes of the act, we

--compared its organizational structure and its level of health services provision to the requirements of the HEW regulations which had been used in qualifying Sound Health; and

--evaluated Sound Health's health services programs to medically underserved areas, high-risk individuals, and the indigent.

Summarized in appendix IV are our determinations on Sound Health's compliance with the act.

## CHAPTER 2

### HAS SOUND HEALTH BEEN ABLE TO MEET

#### THE ORGANIZATIONAL AND OPERATING

#### REQUIREMENTS OF THE HEALTH MAINTENANCE ORGANIZATION ACT?

The HMO Act directs qualified HMOs to be fiscally sound; offer specified health benefits; and meet certain other organizational and operational requirements, including use of a community rating system to develop premium rates. (See app. IV.) Sound Health's financial viability is discussed in chapter 3. Sound Health offers the specified health benefits, meets the organizational requirement, and generally satisfies the operating requirements of a federally qualified HMO.

Provisions not met include

- the open enrollment requirement which Sound Health never fully implemented and which was never formally waived by HEW; and
- the broadly representative membership requirement, which we believe could be better satisfied by Medicare enrollees.

HEW has not published program guidelines for interpreting some operational requirements. For example, although HMOs must establish a community rating system for fixing periodic payments, HEW has not published guidelines to be used in developing such a system (see p. 13).

HEW encourages an HMO to implement certain other program objectives of the act but does not require it. Guidelines have not been established, thus leaving the interpretation to each HMO. An example of such an objective would be in the ways services should be directed toward medically underserved areas.

#### OPEN ENROLLMENT

Prior to being amended section 1301(c)(4) of the HMO Act of 1973 stated that each HMO shall



"\* \* \* have an open enrollment period of not less than thirty days at least once during each consecutive twelve-month period during which enrollment period it accepts, up to its capacity, individuals in the order in which they apply for enrollment."

Sound Health was subject to this requirement during its first year of operation.

Exceptions to the open enrollment requirement could be authorized by the Secretary if the HMO demonstrated, to HEW's satisfaction, that it had enrolled or would be forced to enroll a disproportionate number of individuals who were likely to make excessive use of its services and that enrolling more such individuals would jeopardize the financial viability of the HMO.

In 1975 Sound Health held an 8-day open enrollment period in which 40 members were enrolled. Sound Health requested a waiver of the remaining 22 days for 1975 because:

"Continuation of this open enrollment period would attract more people who are extremely ill and thus put our organization into a questionable financial position because of assumed risk. We believe it would be beyond what this organization could sustain."

Sound Health also requested a waiver of the entire 1976 open enrollment period. The 1976 request noted that about 75 percent of the members who had joined during the 1975 open enrollment period had preexisting and/or chronic medical conditions. These conditions included hypertension, cancer, cardiac problems, diabetes, cataracts, arthritis, and alcoholism. Data maintained for these 40 enrollees showed that their rate of utilization of services had exceeded the average for total enrollees as shown below:

Utilization Comparison  
(October 1974 - March 1976)

<u>Services</u>	<u>Enrollees' annualized rates</u>	
	<u>Open enrollment period</u>	<u>Total enrollees</u>
Office visits	6.9 per member	5.9 per member
X-ray	.95 per member	.9 per member
Hospital days	1,350 per 1,000 members	495 per 1,000 member

The Sound Health director stated that Sound Health had received many inquiries from persons with severe or chronic medical problems as to the date of the next open enrollment. He said that Sound Health cannot afford to accept high-risk individuals--at least not until the membership is large enough to absorb the high per capita costs for such individuals.

Regional HEW and Sound Health officials said that both requests for waiver had been tacitly approved by HEW, but no documentation was available to show the requirement had been waived. HEW headquarters officials have not issued a formal waiver, but neither have they forced Sound Health to have an open enrollment period.

HEW has not issued final criteria for considering requests for waivers. The amendments to the HMO Act changed the open enrollment requirements so that open enrollment is now required for only those HMOs which

- have been providing comprehensive health services on a prepaid basis for 5 years or have 50,000 members and

- did not incur a financial deficit in their most recent fiscal year.

Because of these amendments, Sound Health will not have to have an open enrollment in the near future. It will not have been operating for 5 years as a qualified HMO until late 1979; it had 6,000 members as of December 31, 1976; and it continues to incur deficits.

#### ENROLLMENT OF MEMBERS BROADLY REPRESENTATIVE OF ITS SERVICE AREA

Section 1301(c) of the act requires an HMO to enroll persons broadly representative of various age, social, and income groups within the area served. Federal implementing regulations provide no guidelines defining a "broadly representative" membership. Sound Health is serving the indigent (Medicaid) but has not actively sought enrollment of high-risk (Medicare) individuals. This suggests that Sound Health's membership does not represent various age, social, and income groups in its service area.

## Medicare enrollees

In its application for qualification as an HMO, Sound Health indicated that its health professionals and contract providers were eligible to serve Medicare beneficiaries. Sound Health offers a Senior Plan, which supplements the Federal Medicare program and provides the same health services and benefits available to other Sound Health members. As of April 1, 1976, only 30 members were enrolled under the Senior Plan. The Sound Health director stated that Medicare beneficiary enrollments have not been actively sought because Sound Health would have to act as a fee-for-service provider, which must obtain payment from Medicare.

## Medicaid enrollees

Sound Health has contracted with the Washington Department of Social and Health Services to provide health services to Medicaid beneficiaries. The Sound Health contract became effective July 2, 1975, and was subsequently amended to include the following conditions:

- Enrollment by Medicaid beneficiaries will be voluntary.
- Sound Health will enroll eligible Medicaid recipients throughout the year.
- The Department of Social and Health Services will approve Sound Health's marketing plans, procedures, and materials used to recruit Medicaid enrollees.
- The Department of Social and Health Services will be able to inspect and evaluate the quality, appropriateness, and timeliness of contract services and to audit and inspect books and records.
- Within 2 years after the contract effective date, no more than 50 percent of the Sound Health members may be Medicare or Medicaid beneficiaries.

Sound Health negotiated an increase in the monthly Medicaid premium--from \$17.20 to \$20 per enrollee--effective February 1, 1976. Health care benefits provided to Medicaid members are essentially comparable to those provided to regular members, except that Sound Health is not required to provide mental health and alcohol and drug abuse health care services to Medicaid members.

To attain its goal of 1,000 members from the Aid to Families with Dependent Children program, Sound Health acted as follows to increase Medicaid enrollment. It sent mailings to Medicaid recipients, conducted training sessions for Department of Social and Health Services staff, provided information to social and health service agencies, and evaluated the recruiting program.

Monthly enrollment statistics of Medicaid beneficiaries for February through May 1976 were:

<u>Medicaid Enrollment</u>			<u>Cumulative total</u>
<u>Date</u>	<u>Added</u>	<u>Lost</u>	
January 31	-	-	319
February 1	33	24	328
March 1	22	16	334
April 1	219	49	504
May 1	<u>525</u>	<u>46</u>	983
Total	<u>799</u>	<u>135</u>	

A continuing program provides for mailing information to Aid to Families with Dependent Children program participants every 6 months.

#### Service to medically underserved areas

The Secretary of HEW may designate areas which have a shortage of personal health services as medically underserved. HMOs are not required to serve such areas, but HEW encourages them to do so.

HEW classified 10 census tracts in Pierce County as medically underserved areas, each within the Sound Health immediate service area. The Sound Health clinic is in an area classified as medically underserved.

Sound Health officials stated it has not emphasized service to underserved areas because, except for Medicaid beneficiaries, marketing is conducted through employee groups without regard to the residence of prospective members. Although some Sound Health members are in medically underserved areas, this has occurred by accident rather than design.

## DESCRIBING THE COMMUNITY RATING SYSTEM

Originally section 1301(b)(1) of the act requires that payment for basic health services provided by the HMO be fixed under a community rating system. Section 1302(8) of the HMO Act, as amended, defines a community rating system as

"\* \* \* a system of fixing rates of payments for health services. Under such a system rates of payments may be determined on a per-person or per-family basis and may vary with the number of persons in a family, \* \* \*.

\* \* \* such rates must be equivalent for all individuals and for all families of similar composition."

Nominal differentials in payment rates are permitted for certain categories of members to reflect the different administrative costs of collecting payments. Differentials may also be established for members enrolled under contract with a governmental authority or any health benefit program for employees of States, political subdivisions of States, and other public entities.

Sound Health officials said its premium rates are an adjusted experience rate for the entire membership. In determining the premium rates, Sound Health divides the total budgeted costs by the forecasted member months. In addition, the rates are partially determined by local competition. Our comparison of rates for competitive health benefit plans suggests Sound Health could raise rates 10 percent above projections and still be competitive with other plans. (See p. 19.)

As of July 1, 1976, Sound Health premium rates were:

<u>Coverage</u>	<u>Monthly premium</u>
Employee	\$27.00
Employee and spouse	54.00
Employee, spouse, and child(ren)	79.51
Employee and child(ren)	52.81
Employee (Medicare supplement)	13.50

HEW has not published, nor has it any specific plans for publishing, program guidelines to interpret how community rating should translate into a premium structure. As a result we could not determine if Sound Health's rate structure complies with act requirements for a community rating system. The HMO amendments have changed application of the community rating requirement to after the HMO has been qualified for 48 months.

### CHAPTER 3

#### WILL SOUND HEALTH BE ABLE TO OPERATE

##### WITHOUT CONTINUED FEDERAL FINANCIAL ASSISTANCE?

As stated in chapter 1, the HMO Act requires each qualified HMO to be fiscally sound. However, because a developing HMO may have difficulty in meeting initial operating expenses, section 1305 of the act, as amended, provides for Federal loans, not to exceed \$1 million in any fiscal year or \$2.5 million in total, to assist during its first 36 months of operation. HMOs eligible for loans must be certified as qualified. However, to become qualified, an HMO must be fiscally sound. For Sound Health the Federal loan establishes fiscal soundness.

Sound Health obtained a Federal loan of \$1 million effective November 1, 1974. We question Sound Health's ability to break even by November 1977, as planned. However, our actuarial projections indicate that even though Sound Health will not break even as planned, its cash flow will permit payments on the loan principal to begin in July 1979 as scheduled.

According to the loan agreement, Sound Health will pay only interest until July 1979 when it must begin principal repayment. Projections prepared by Sound Health with HEW assistance in June 1976 showed Sound Health having sufficient operating revenues to meet operating expenses by November 1977. However, Sound Health

- has failed to meet enrollment projections in the past--  
partially due to Federal delays in publishing dual-choice regulations,
- continues to have marketing problems, and
- has experienced unnecessary and unanticipated costs.

Sound Health must overcome these difficulties to continue without Federal financial assistance. Changes in rates charged by Sound Health, reductions in planned overhead costs, or other organizational changes could significantly improve Sound Health's financial position.

## OPTIMISTIC ENROLLMENT PROJECTIONS AND MARKETING PROBLEMS

The enrollment projection from Sound Health, submitted with its application for qualification in 1974, was revised in June 1976. This revision predicts an enrollment increase from 3,048 in March 1976 to 13,931 in November 1977--an average increase of 544 members a month. This increase appears overly optimistic in light of past performance. Sound Health's average monthly increase was 202 and 257 members during the third and fourth quarters of 1975, respectively, and 249 members per month during the first 6 months of 1976. The 1976 figures included a Medicaid enrollment increase of 525 during May. During the quarter ended March 1976, about 76 percent of Sound Health's revenue was from membership dues. The remainder was generated through copayments, fee-for-service income, and interest income. Sound Health expects to obtain over 90 percent of its revenue from membership dues.

Our actuarial assessment of the future financial viability of Sound Health suggests that improved marketing is crucial for Sound Health's success. Even assuming an improvement in marketing, we believe the Sound Health enrollment projections may be overstated unless additional membership sources are identified.

The enrollment projections submitted with Sound Health's qualification application in 1974 have proven overly optimistic, as shown on the following chart.



# COMPARISON OF ACTUAL AND PROJECTED ENROLLMENT

NUMBER OF MEMBERS

18,000

16,000

14,000

12,000

10,000

8,000

6,000

4,000

2,000

0

12/74

6/75

12/75

6/76

12/76

6/77

12/77

SOUND HEALTH  
1974 ENROLLMENT  
PROJECTION

GAO  
ENROLLMENT  
PROJECTION

SOUND HEALTH  
1976 ENROLLMENT  
PROJECTION

ACTUAL ENROLLMENT

Federal delays in the HMO qualification and certification process and in publishing regulations and guidelines to implement the dual-choice provisions of the act have contributed to Sound Health's failure to meet enrollment expectations. However, several other factors have contributed and continue to contribute to this condition, including

- Sound Health's lack of organization in its marketing effort,
- employer resistance to the act (see ch. 4), and
- local union resistance to Sound Health (see ch. 4).

An HEW official conducted a marketing assessment of Sound Health in 1974 and reported that, "I was surprised to find that the basic data essential to make intelligent marketing decisions has not been acquired in spite of 3 years and \$700,000 of involvement to date." Our actuarial review showed that, even assuming an improvement in marketing, Sound Health enrollment projections may be substantially overstated unless additional membership sources are identified. (See app. V, p. 36.)

Sound Health's success in enrolling employee groups has been mixed. The first year rate of penetration--that is, the percentage of employees who chose to enroll during the first year the plan was offered to their respective employer--was 3.1 percent. Enrollment efforts in April 1976 included failure to enroll anyone in a company with 1,100 eligible employees. The plan also enrolled only 10 in a company with 985 employees, 1 in a group of 170, and none out of 150. In commenting on our draft report, a Sound Health official pointed out these failures were due to problems with union acceptance and inability to obtain access to employees. However, as noted on page 11, Sound Health did have significant Medicaid enrollment.

Recently, the Sound Health director moved to organize the marketing function, including establishing a data base on Pierce County employers.

For employees represented by a labor union, the offer of the HMO alternative is subject to collective bargaining. Sound Health's entrance into the health benefit programs of local unions has been very limited, and Sound Health faces strong union resistance. However, both Sound Health and union officials told us this resistance stemmed from conflicts

between them rather than weaknesses in the Sound Health plan or the HMO Act. (See ch. 4.)

Publication of the dual-choice guidelines and regulations in October 1975 and Sound Health's certification for dual-choice in January 1976 should improve Sound Health's marketing. Also, the Civil Service Commission has approved Sound Health to participate in the Federal Employees Health Benefits Program beginning January 1, 1977. The Sound Health director said that over 10,000 Federal civilian employees live in Pierce County, making the Federal Government one of the largest area employers.

#### HIGHER THAN ANTICIPATED UTILIZATION

Sound Health has operated at a deficit since it became operational in April 1974. During calendar year 1975, it incurred an operating loss of \$549,169, or \$108,645 more than anticipated. Much of this loss can be attributed to Sound Health's failure to meet enrollment expectations. However, some of the loss resulted from higher than anticipated costs, particularly in health service payments to providers who are not on the Sound Health staff (referral costs). Referral costs incurred during 1975 exceeded Sound Health's cost projection by more than \$67,000.

Sound Health also underestimated and underbudgeted for these costs during the first quarter of 1976. Referral costs exceeded the budget by \$50,978. The Sound Health director said that about \$15,000 of the first quarter 1976 referral costs were avoidable because services could have been provided by Sound Health. He stated that controls on referrals had been implemented in April 1976. For example, X-rays and laboratory tests are now performed by Sound Health, and plan approval is required before members may be hospitalized. Referral costs were reduced from \$80,456 in the first quarter of 1976 to \$49,178 in the second quarter.

In commenting on our draft report, Sound Health's executive director clarified the point on referral costs. He stated that beginning in April of 1976, "we instituted more strict controls over referrals to all outside specialists in the areas of lab and X-ray. Whenever possible we also control the tests being done prior to hospitalization by having them done at our health center."

The director told us that because an HMO cannot refuse to enroll individual members of a group covered by other health plans offered by the employer, some employees with

preexisting health care needs convert to HMO coverage during group enrollment periods when it is economically advantageous for them. According to the director, Sound Health has been adversely affected by many group enrollees with preexisting cardiac, cancerous, orthopedic, and other conditions requiring extensive treatment. Similarly, the director said that from December 1975 to May 1976, Sound Health enrolled 30 pregnant members. The Sound Health finance director said that maternity costs account for \$3.66 of the monthly premium rate.

#### AUDIT OF SOUND HEALTH

Sound Health's 1974 and 1975 financial statements were audited by a certified public accounting firm and found in order. The HEW Audit Agency performed a quick assessment audit of Sound Health in August 1974 and a followup audit in August 1975. The 1974 quick assessment audit disclosed several weaknesses which Sound Health needed to correct to provide proper management of and accountability for grant funds. The HEW followup audit reported that most of the deficiencies had been corrected or resolved. Deficiencies reported in August 1974 which we still found in April 1976 included untagged nonmedical equipment and a statement by the financial officer that a physical inventory of equipment had never been taken. Two deficiencies noted in the 1975 audit report had been referred to the region X HMO branch but had not been resolved at the time of our review. The report states that:

- Sound Health inappropriately allocated about \$13,000 (\$11,766 Federal share) in costs to its HMO development grant.
- Sound Health had inappropriately applied \$58,830 in operating costs to the HMO development grant. It then used loan funds to replace the grant funds.

Sound Health's comments on our draft report acknowledged a need for a more up-to-date physical inventory and affirmed plans for an annual inventory.

#### OUR FINANCIAL PROJECTION

Our analysis of the future financial viability of Sound Health indicated that proposed premium rates must be increased for Sound Health to break even. Appendix V contains our actuarial assumptions and projections. A comparison of rates for competitive plans suggests Sound Health could raise

rates 10 percent above its already projected increase and still be competitive with other plans.

In commenting on our draft report, Sound Health said some difference may exist in the competitive health plans that were compared. We agree that differences in health benefits offered may exist. However, the rates below were offered to the same group which required a set of minimum benefits to be included in the four health plans.

Comparison of Sound Health Monthly  
Premium Rates With Competitive Plans (note a)

<u>Persons under 65</u>	<u>Sound Health</u>	<u>Blue Cross</u>	<u>Group Health</u>	<u>Western Clinic</u>
Employee	\$27.60	\$ 41.90	\$29.83	\$53.64
Employee and spouse	55.20	83.15	58.53	63.13
Employee, spouse, and child(ren)	81.25	118.00	84.68	89.25
Employee and child(ren)	53.70	76.75	53.76	61.76

a/Rates offered to Washington State employees in 1976 as obtained from a brochure entitled "State Employees Insurance, Board Approved Medical Plans."

With a 10-percent increase, we project operating profits for Sound Health during the second quarter of 1979 when its membership approaches 20,000. The following schedule shows our projections.

	<u>Enrollment</u>	<u>Income</u>	<u>Expenses</u>	<u>Profit/ Loss(-)</u>
1976	5,293	1,003,734	1,545,547	-541,813
1977	10,772	3,244,022	3,666,889	-422,867
1978	16,363	5,899,639	6,193,692	-294,053
1979	21,626	8,875,044	8,821,019	54,025
1980	25,000	11,650,968	11,130,115	520,853

## CONCLUSIONS

For Sound Health to become financially viable without continued Federal financial assistance, we believe it needs increased premium rates and more members. Although we question Sound Health's ability to break even within the 36-month subsidy period prescribed in the HMO Act, we believe they can accomplish this within 5 years.

## CHAPTER 4

### WHAT IS THE EFFECT OF DUAL CHOICE ON EMPLOYERS AND SOUND HEALTH?

Section 1301 (the dual-choice provision) of the HMO Act, as amended, provides that every employer, which (1) has at least 25 employees in the HMO's service area, (2) is required to pay the minimum wage, and (3) provides health benefits to employees, must offer employees the option of joining a qualified HMO. The act relieves an employer from contributing more to the cost of the HMO plan than it contributes to other health benefits plans.

We contacted 16 employers, 3 labor representatives, and an insurance consulting firm in the Sound Health service area to determine

- the economic effect on employers of offering Sound Health membership to employees as an optional health plan in compliance with the HMO Act,
- employer reaction to the act,
- how Sound Health has used dual choice and its effect upon Sound Health, and
- union response to Sound Health and the HMO Act.

The employers contacted in the Sound Health service area reported no significant economic impact from the requirement that Sound Health membership be included as an option to employees in their health benefit programs, and none of the employers had measured the effects of Sound Health membership on the health of their employees. Employer attitudes toward the act ranged from lack of concern to strong resentment of Federal interference in their business.

### ECONOMIC IMPACT ON EMPLOYERS

Employers which offered Sound Health membership as a dual-choice option to their employees said the effect on administrative costs was negligible. The employer contributions for employee health benefits generally remained the same. However, some employers said that they had voluntarily changed their contributions but had not measured the cost differences. For example, one employer's contribution amounted to 10 percent of employee health plan premium costs for each year of

employment with the firm, regardless of the health plan selected. Another employer, a self-insurer, contributed up to \$36 a month for health benefits for an employee and his dependents under the company's indemnity plan. The employer agreed to pay the same amount toward Sound Health membership. In addition, this employer agreed to pay the entire Sound Health premium up to \$36 a month for individuals without dependents, even though premium costs for such employees under the company's plan is only \$21 a month. The employee benefits director said that generally high health service users tend to select an HMO to avoid the deductibles and payments required in the company plan. Therefore, while Sound Health premiums may be slightly higher, costs to the company as a self-insurer may be lower because of the high medical utilization costs shifted to Sound Health. However, the employer has not measured or studied the effect of this practice.

Employers also said the dual-choice provision has not noticeably affected their relationships with other health plans or representatives of these health plans.

#### EMPLOYER REACTION

Several employers contacted expressed resentment about the HMO Act; others said they were indifferent. Employers said their resentment stems from the level of Federal "interference" in their businesses, not from Sound Health.

Employer representatives said, and Sound Health agreed, that it has not emphasized the employer's legal obligation to offer Sound Health's benefit plan. The marketing approach used has been to explain the benefits of the plan and request employer support. Through trade associations, publications, professional organizations, and sources other than Sound Health, many employers we contacted became aware of their legal obligation to offer an HMO. Sound Health has sent written dual choice notifications to those employers which (1) initially refused to offer dual choice, (2) requested written notification, or (3) strongly resisted the program. Sound Health had sent such letters to 69 employers in the first 4 months of 1976.

The Sound Health director said several employers had not offered the Sound Health plan until implementing regulations had been published and Sound Health was qualified for dual choice. The qualification delay contributed to Sound Health's failure to meet enrollment projections. Based on our contact with local employers, we believe Sound Health will be able to enroll more employer groups because of the dual choice regulations.



Three employers said they were uncertain if they were obligated to offer the Sound Health plan if most of their employees were receiving health benefits from union health and welfare trusts.

#### UNION RESISTANCE

Local union officials said unions in Pierce County have expressed strong resistance to Sound Health. This stemmed from conflicts between Sound Health and union officials, not weaknesses in the Sound Health plan or the HMO Act. Only two unions in the area signed group sponsorship contracts with Sound Health, and only about 600 members were eligible under these contracts. Union officials said they knew of no restrictions that would prevent them from offering an HMO option to their members.

Union officials also said that one union had presented the Sound Health plan at a membership meeting. After being told by a local union leader that only one health plan could be selected by the group, the membership, by majority vote, chose their present carrier.

## CHAPTER 5

### QUALITY ASSURANCE PROGRAM

Section 1301(c)(8) of the act requires each HMO to establish an ongoing quality assurance program which stresses health outcomes and provides for review by physicians and other health professionals of processes for providing health services. HEW regulations state that each HMO shall have a quality assurance program which

--collects systematic data on performance and patient results and

--is designed to meet the professional standards review established under the Social Security Act for services provided by hospitals and the operating health care facilities or organizations.

The Sound Health quality assurance program adopted in February 1974 included the following policies and Sound Health implementing actions:

#### Qualification of medical group members

The Sound Health medical director stated that all its staff physicians are board certified or board eligible.

#### Management information system

Elements of the management information system are examined to identify real or potential problems. Management information system data shows the number of encounters by each Sound Health provider, referrals to outside providers, and quantitative use of other medical services. For example, the finance director said analysis of the system had alerted Sound Health to an increase in referral costs during the first quarter of 1976. (See p. 18.)

#### Member relations

Sound Health surveyed members in 1975 and 1976 to obtain opinions on its health services. Generally, members were asked if such items as waiting time, medical staff competence, and medical facilities were satisfactory or unsatisfactory. Sound Health also established committees to deal with health benefits and member grievances.

### Medical audit

The Sound Health medical director stated that because of the limited number (three) of Sound Health physicians, no systematic peer review of medical procedures exists. However, he told us the medical staff meets weekly. Sometimes the procedures prescribed for specific cases are discussed, but no documentation is kept for these informal case reviews. Region X HEW officials stated they are helping Sound Health develop a systematic peer review program.

### Continuing education

Many (12 out of 29) professional staff participated in the Sound Health continuing education courses during 1974-75.

HEW, in its review of the Sound Health HMO qualification application, noted the Sound Health quality assurance and continuing education programs followed the regulations.

We were told that all hospitals under contract with Sound Health have State-approved utilization review procedures. The Professional Standards Review Organization in this region performs peer review activities in short-term, acute care hospitals only and has yet to implement ambulatory care peer review in facilities such as Sound Health's outpatient clinic.

In our opinion Sound Health should establish a more formal peer review system to insure the quality of care administered by its providers. Such a system should include documented regular review of systematically selected cases.

HARRISON A. WILLIAMS, JR., N.J., CH.  
 JENNINGS RANDOLPH, W. VA.  
 CLAUDINE PELL, R.I.  
 EDWARD M. KENNEDY, MASS.  
 GAYLORD NELSON, WIS.  
 WALTER F. MONDALE, MINN.  
 THOMAS F. EASLETON, MD.  
 ALAN GRANSTON, CALIF.  
 WILLIAM D. DONAHAY, MAINE

DONALD ELLIOTT, GENERAL COUNSEL  
 MARJORIE M. WHITTAKER, CHIEF CLERK

JACOB K. JAVITS, N.Y.  
 RICHARD S. SCHWEIZER, PA.  
 ROBERT TAFT, JR., OHIO  
 J. GLENN BEALL, JR., MD.  
 ROBERT T. STAFFORD, VT.  
 PAUL LARALEY, NEV.

## United States Senate

COMMITTEE ON  
 LABOR AND PUBLIC WELFARE  
 WASHINGTON, D.C. 20510

May 24, 1976

B-164031(5)

The Honorable Elmer B. Staats  
 Comptroller General of the United States  
 General Accounting Office  
 441 G Street, N.W.  
 Washington, D.C. 20548

Dear Mr. Staats:

In April, members of your staff provided information to our staff regarding the General Accounting Office's initial reviews of Health Maintenance Organizations under section 1314(a) of the Health Maintenance Organization Act of 1973. In addition to expressing the Subcommittee's appreciation for the assistance your staff has provided the Subcommittee in exercising its oversight responsibility and in its deliberation on S.1926, the purpose of this letter is to confirm the review approach presented by your staff.

We understand that GAO has started a review of two qualified HMOs as a beginning point for meeting its requirements under section 1314(a) as it would be amended by S.1926. Mr. James Martin's November 21, 1975 testimony before the Subcommittee has indicated that the slow rate of progress in establishing "qualified" HMOs along with the lack of an accepted or generally agreed upon methodology for evaluating the impact of HMOs on the health of the public would prevent GAO from meeting the reporting deadline (December 29, 1976) for the evaluations called for by sections 1314(b) and 1314(c). The Subcommittee acknowledges that in view of the unanticipated delays in implementing the HMO Act of 1973, the 36 month reporting requirements for sections 1314(b) and (c) now appear unrealistic and are virtually moot. However, the Subcommittee is pleased to note that GAO is planning to include elements of subsections (b) and (c), in its reviews of the individual "qualified" HMOs, specifically: (1) evaluations of the economic effects of section 1310 upon the employers that have included the "qualified" HMO in their employee health benefit programs and (2) descriptions of the quality of care assessments and evaluations in each HMO.

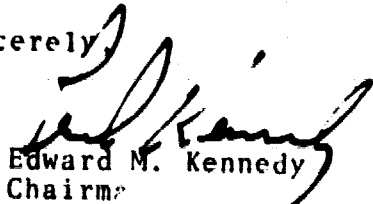
As your staff complete the reviews of each HMO, we would like reports on each review forwarded to us (and as previously discussed with our staff, copies to the Chairman and Ranking Minority Member of the House Subcommittee on Health and Public Environment, Interstate and Foreign Commerce Committee). You may supply copies of the individual reports to DHEW and to the Civil Service Commission to assist them in the performance of their regulatory and monitoring duties over HMOs. A summary report to the Congress would be submitted by June 1978 as called for by section 1314(a) as amended by S.1926.

Again, the work by your Manpower and Welfare Division staff on the implementation of the HMO Act by DHEW and the GAO questionnaire survey of prospective HMO grant applicants have greatly assisted us in our deliberations on the HMO amendments of 1975. We look forward to receiving the final report on this effort as well as the reports on your planned reviews on HMOs.



Richard S. Schweiker  
Ranking Minority Member  
Senate Subcommittee on  
Health

Sincerely,



Edward M. Kennedy  
Chairman  
Senate Subcommittee on  
Health

## SOUND HEALTH ASSOCIATION

July 26, 1977

Mr. Gregory J. Ahart, Director  
United States General Accounting Office  
Human Resources Division  
Washington, D. C. 20548

Dear Mr. Ahart:

We have reviewed the draft of a proposed report prepared by the Comptroller General of the United States on the evaluation of Sound Health Association, a federally qualified HMO.

We are attaching a list of corrections that we think should be made prior to publication of the study.

Generally the report is a fair and accurate expression of the position of Sound Health Association as it was in June 1976. The report succinctly reported the evolution of our organization to its present status.

As the letter indicates the study is late in being published. A great deal has happened since the original study. For example, our organization has reached a membership of 9200. It has a better organized marketing system and we have matured considerably within the year on the operational levels. The controls we imposed on health services are working well and we are seeking ways to control other expenses as effectively.

We invite you to return and do a follow-up assessment and perhaps explore some other aspects of HMO development such as manpower development in the HMO movement or evaluation of the development process itself.

Sincerely yours,

Robert E. Huesers, President

REH:ng  
cc: Lou Smith, GAO, Seattle

**GAO note: The attachment pertains to material that was included or deleted from the report.**

**SOUND HEALTH ASSOCIATION OPERATING RESULTS FOR THE**  
**QUARTERS ENDED MARCH 1975 THROUGH MARCH 1976**

	<u>Quarter Ended</u>				
	<u>March</u> <u>1975</u>	<u>June</u> <u>1975</u>	<u>September</u> <u>1975</u>	<u>December</u> <u>1975</u>	<u>March</u> <u>1976</u>
<b><u>Income:</u></b>					
Member dues	\$45,532	\$54,177	\$72,528	\$117,028	\$154,430
Copayments	353	900	399	1,365	2,950
Fee for service and other operation income	20,348	15,312	18,286	30,396	32,290
Interest income	<u>20,284</u>	<u>2,511</u>	<u>3,699</u>	<u>31,566</u>	<u>13,419</u>
Total income	<u>\$86,517</u>	<u>\$72,900</u>	<u>\$94,912</u>	<u>\$180,355</u>	<u>\$203,089</u>
<b><u>Expenses:</u></b>					
Physicians	\$ 23,864	\$ 18,676	\$ 23,533	\$ 41,955	\$ 30,851
Health center operations	35,632	52,759	49,593	33,593	73,187
Hospital care	8,142	4,631	23,248	53,081	79,022
Drugs and vision care	4,399	5,545	7,904	9,361	13,781
Other contracted health services	16,851	8,256	29,249	63,900	80,456
Reinsurance and out of area	1,183	2,046	2,539	5,831	5,989
Facilities and equipment	19,056	21,940	25,053	12,198	20,819
Administration	37,472	32,824	32,846	47,583	47,184
Enrollment	18,076	29,379	19,584	24,793	24,420
Business taxes	908	1,113	1,524	2,165	2,768
Interest	24,076	23,426	23,606	26,796	25,698
Authorization and develop- ment costs	<u>8,393</u>	<u>8,393</u>	<u>8,393</u>	<u>8,393</u>	<u>8,393</u>
Total expenses	<u>\$198,052</u>	<u>\$208,988</u>	<u>\$247,072</u>	<u>\$329,739</u>	<u>\$412,568</u>
Revenue Loss(-)	<u>-\$111,535</u>	<u>-\$136,088</u>	<u>-\$152,160</u>	<u>-\$149,384</u>	<u>-\$209,479</u>
Average number of members	877	1,008	1,468	2,180	2,944



ORGANIZATIONAL AND OPERATING REQUIREMENTSFOR HEALTH MAINTENANCE ORGANIZATIONS

	<u>In compliance</u>	<u>Not in compliance</u>
The HMO shall be a legal entity which provides:	X	
Basic health services for a basic health service premium which is:	X	
--paid on a periodic basis without regard to the dates health services are provided	X	
--fixed without regard to the frequency, extent or kind of health services actually furnished	X	
--fixed under a community rating system	X (as defined by Sound Health; see ch. 2)	
--may be supplemented by additional nominal payments, except that such payments may not serve as a barrier to delivery of health services.	X	
Supplemental health services for a supplemental health service payment which is fixed:	X	
--on a prepayment basis,	X	
--under a community rating system.	X (as defined by Sound Health; see ch. 2)	
The services of health professionals which are provided as a basic health service shall be provided through health professionals who are members of the staff of the HMO, through a medical group or individual practice association unless the health pro- fessionals services are unusual or infrequently used or the basic health service was provided because it was	X	

	<u>In compliance</u>	<u>Not in compliance</u>
medically necessary and could not be provided by such a health professional.	X	
Basic and Supplemental Health Services shall be available, accessible and be provided in a manner that assures continuity and when medically necessary be available and accessible twenty-four hours a day and seven days a week.	X	
A member of an HMO shall be reimbursed by the organization for his expenses in securing basic or supplemental health services other than through the organization if it was medically necessary.	X	
An HMO should have a fiscally sound operation and adequate provision against the risk of insolvency which is satisfactory to the Secretary.	X (with some changes needed; see ch. 2)	
An HMO should assume full financial risk on a prospective basis for the provision of health services, except that the HMO may obtain insurance or make other arrangements.	X	
An HMO shall enroll persons who are broadly representative of the various age, social and income groups within the area it serves.		X
An HMO shall have an open enrollment period of not less than thirty days at least once during each consecutive twelve month period during which enrollment it accepts, up to its capacity, individuals in the order in which they apply, [Unless] the HMO demonstrates to the Secretary the need for a waiver.	X (During our review, Sound Health was not in compliance. However the act, as amended, does not require open enrollment until certain criteria are met; see p. 9)	

	<u>In compliance</u>	<u>Not in compliance</u>
A: HMO shall not expel or refuse to re-enroll any member because of his health status or his requirements for health service.	X	
An HMO shall be organized in such a manner that assures that at least one-third of the membership of the policy-making body of the HMO be members of the organization and there shall be equitable representation on the member portion of the policymaking body of members from the medically underserved populations in proportion to their enrollment relative to the entire enrollment.	X	
An HMO shall be organized in such a manner that provides a meaningful procedure for hearing and resolving grievances between the HMO and the members of the organization.	X	
An HMO shall have an organizational arrangement for an ongoing quality assurance program which stresses health outcome and provides review by physicians and other health professionals of the process followed in the provision of health services.		X (some improvements are needed; see ch. 5)
An HMO shall provide for its members:		
--medical social services	X	
--encourage and actively provide for its members' health education services.	X	
An HMO shall provide or make arrangements for continuing education for its health professional staff.	X	
An HMO shall provide for an effective procedure for developing, completing, evaluation, and reporting to the Secretary statistics and other information:		

	<u>In compliance</u>	<u>Not in compliance</u>
--cost of operations	X	
--patterns of utilization of services	X	
--availability, accessibility, and acceptability of its services	<u>a/</u>	
--to the extent practical developments on the health status of its members	<u>a/</u>	
--such other matters as the Secretary may require.	<u>a/</u>	

---

a/HEW has not completed reporting requirements.

GAO ACTUARIAL PROJECTIONS  
FOR SOUND HEALTH ASSOCIATION

Our analysis of the Sound Health financial outlook indicates it is unlikely to succeed under the rate structure proposed by Sound Health's finance director. A comparison of rates for competitive plans suggests Sound Health could raise rates 10 percent above those projected and still be competitive with the other plans. We made a second projection, assuming Sound Health would increase premiums 10 percent above projected amounts as of January 1977. Under this assumption the plan would begin to have operating profits during the second quarter of 1979. Cash flow problems will probably not occur if the HEW loan to Sound Health is increased to \$2 million, as expected by Sound Health, and if the loan period is extended beyond 3 years, as authorized in the 1976 amendments to the HMO Act. The first payment on the principal is scheduled for July 1979.

For Sound Health to succeed it must improve its marketing significantly. The executive director of Sound Health has expressed willingness to move toward achieving this. Even assuming an improvement in marketing, we believe that Sound Health enrollment projections may be substantially overstated, unless additional membership sources are identified.

The major differences in assumptions used in the Sound Health projection (showing a fourth quarter 1977 break-even point) and our projections are summarized as follows.

<u>Assumption</u>	<u>Sound Health projection</u>	<u>GAO projection</u>
Inflation factor	10-percent simple rate (not com- pounded)	10 percent compound rate, 20-percent effective rate for malpractice insurance, and 10 percent additional premium
Hospital utiliza- tion	450 days per 1,000 members a year	480 days per 1,000 members a year

Facility expansion	Delay adding facilities. It is unclear from projection worksheets where members are to be cared for after original facility is outgrown.	Lease second facility when enrollment reaches 12,500. Stop enrollment activities when membership approaches the 25,000 limit of 2 facilities.
Enrollment	Initial penetration rates of 5 percent for some specific major employers (Federal, and State Government, Boeing, etc.). It is unclear what enrollment increases were assumed to be. Approximately straight line increases in nongroup enrollment, and Medicaid enrollment spurts for Medicaid in April and October after semiannual mailings.	Accepted Sound Health projected Medicaid and non-group enrollment increases. Assumed enrollment increases for 25 or fewer employment or less approximately equal the increase between 3/1/75 and 3/1/76. Initial penetration rate of 3.8 percent for large groups with semiannual increase for 3 years of 1.5 percent (3 percent annual increases for Federal employees). Peak penetration after the fourth year of 12.8 percent. Used specific enrollment drives planned by Sound Health when available. Assumed drives in 10 firms per quarter averaging 75 employees for remaining months through end of 1979, when all major employers will have been contacted. Assumed 2.3 plan members per employee.

### INFLATION FACTOR

We accepted the 10-percent rate used by Sound Health but applied as a compound rate. A 10-percent simple rate (used by Sound Health) results in a 50-percent increase after 5 years. A 10-percent compound rate (used by us) results in a 61-percent increase after 5 years.

Feb. 1976 Seattle area medical expense consumer price index = 169.6

Feb. 1972 Seattle area medical expense consumer price  
index = 122.9

Annual effective rate of increase = 8.4%

100 = Jan. 1967

Feb. 1976 national hospital charges consumer price  
index = 144.1

Jan. 1972 national hospital charges consumer price  
index = 100.0

Annual effective rate of increase = 9.6%

100 = Jan. 1972

"Jan./Feb. 1975 Malpractice Digest" published by St. Paul Fire and Marine Insurance quotes malpractice premium increases over the previous 5 years as 154-percent for low-risk doctors (non-surgeons) and 172 percent for high-risk doctors--effective annual rates of about 21 and 22-percent, respectively.

#### PREMIUM INCREASE

For Sound Health to become viable under our assumptions, a 10-percent rate increase above that projected by Sound Health would be required. A premium comparison, based on a chart in the brochure "State Employees Insurance, Board Approved Medical Plans" (see p. 20 of report), indicates that such an increase would leave Sound Health rates competitive with all listed plans except Blue Cross low option (benefits not comparable) Kaiser (not available in Tacoma) and well below Blue Cross high option rates.

#### UTILIZATION RATE

The finance director of Sound Health said he assumed the hospital utilization rate could be reduced to 450 days for 1,000 members by postponing elective surgery (such as vasectomies) until fewer than a prescribed number of Sound Health members were hospitalized. We don't believe Sound Health can achieve the dramatic enrollment improvement needed for success and also refuse to provide benefits as promised. Therefore, GAO used a utilization rate closer to actual hospital use.

### Hospital utilization for the 1st quarter of 1976:

2,855 members in Jan. x 533 annual days  
per 1,000 = 1,522 annual days

2,929 members in Feb. x 524 annual days  
per 1,000 = 1,535 annual days

3,048 members in Mar. x 429 annual days  
per 1,000 = 1,307 annual days

Total 4,36

÷ Total member months (2,855 + 2,929 +  
3,048) ÷ 8,832,000 members

494 annual days  
per thousand  
members

### FACILITY EXPANSION

The original projection of the Sound Health finance director showed a second facility would have to be leased when enrollment approached 12,500 and a third facility would be needed at a membership of 25,000. He then revised his projection, eliminating the lease expense for additional facilities and adding a variable expense when membership exceeds 14,000. We know of no way of adding parts of facilities as each new member joins. The only alternative is to add a new facility when the existing one is outgrown. Adequate facilities are crucial to a successful marketing program. We, therefore, used Sound Health's original projection. Since our projection indicated that membership would peak at around 26,000, we assumed a cutoff of enrollment activity at the 25,000 level, which would be the capacity of the 2-facility operation. Sound Health stated that our assumption could apply within the initial period of Sound Health development, but they expect to have other facilities in a larger capacity in years to come.

### ENROLLMENT AND PENETRATION RATES

A 3.8 percent first year penetration rate, that is, the percentage of employees enrolled during the first year the plan was offered to respective employers would be a significant improvement over recent Sound Health experience. The calculations below show a first year rate as of March 1, 1976, following the initial offering and may



reflect some reenrollments and the initial enrollments. The first year rate for the period ended March 1, 1976, was 3.1 percent. Sound Health's April 1976 enrollment drives included such failures as Pacific Northwest Bell--10 out of 985, Tacoma Housing Authority--0 out of 150, Boeing--0 out of 1,100, Pierce County Health Department--1 out of 170. A Sound Health official pointed out that these failures were due to problems with union acceptance and inability to obtain access to employees. Projected improvement is hoped for because of the apparent willingness of Sound Health's executive director to improve Sound Health's marketing department and to finalize dual-choice regulations.

The Community Health Care Center Plan of New Haven, Connecticut, opened in October 1971. Its penetration rates have averaged 5.9 percent for the first year and 14.3 percent for the fourth year, and have leveled off in the fifth. The straight-line rate of penetration increase has been  $\frac{14.3-5.9}{3} = 2.8\%$ . We assumed a 3-percent rate of increase for Sound Health since it is starting from a lower initial rate.

Penetration Rate Computed for  
Groups Under Contract as of 3/1/76

3/1/76 - Employees in Sound Health from firms with 24 or fewer employees	161
3/1/75 - Employees in Sound Health from firms with 24 or fewer employees	<u>99</u>
Increase in employees enrolled	62
x 2.3 average members per employee	<u>x2.3</u>
Increase in membership	142.6
÷ 12	<u>÷ 12</u>
Monthly membership increase	12

<u>Firms of 25 employees or more</u>	<u>Employees</u>	<u>First-year enrollees</u>	<u>Penetration rate</u>
Under contract as of 3/1/75	5,889	307	5.2%
Contracted 3/1/75 through 3/1/76	<u>11,467</u>	<u>358</u>	3.1%
Combined	<u>17,356</u>	<u>665</u>	3.8%

Omitted from this calculation were Sound Health, which has 100-percent penetration; a bank corporation (Sound Health advised us that it expects very little success with banks); and the State of Washington (which had had no enrollment drive as of March 1976).

We obtained a schedule of enrollment drives for December 1976 through September 1977 and noted that the Civil Service Commission had approved offering Sound Health to 10,000 Federal employees effective January 1977. For those months for which no enrollment drive information was available, we assumed that 10 firms could be contacted a month, averaging 75 employees a firm. The average number of employees came from a listing provided by Sound Health. We eliminated firms with fewer than 25 employees and firms already under contract or scheduled for enrollment drives. The remaining 351 firms on the list had 26,292 employees (an average of 75 a firm). In addition to the firms on the list, we included 13 firms not listed, each averaging 75 employees. These assumptions result in no additional major employers to enroll after December 1979. We also assumed neither substantial increases nor decreases of employment will occur in the Tacoma area.

HEW's HMO Reporting System Report on "Membership per Contract for Federally Qualified Health Maintenance Organizations" for the quarter ended December 1975 shows that Sound Health had averaged 2.3 members per contract for all contracts and 2.2 members per contract for group contracts. We used the higher average.

(10233)